



Remarks For

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IDEAS TO MARKET**

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I'm honored to be here today; it's a privilege to speak to such a distinguished group on this important topic. I think that the information we're sharing here today contains valuable lessons about how innovation is enabled in different countries.

By way of introduction, I run the United States Small Business Administration, which was created in 1953 to foster and enable small business ownership.

Our primary objective at SBA is to empower innovative entrepreneurs who start with an idea or a dream that they want to commercialize. We want to see these entrepreneurs turn that idea into a successful business because that's what drives the U.S. economy. Our focus is not just on inventors and new concepts, but enabling economic growth, community development and private ownership.

Any time we look at a financial need, we have to consider:

- What we are trying to enable
- Do we have the right form of capital for what we're trying to enable
- Who should provide it

The third question is particularly important to us as we consider our mission. Government programs can be used to supplement or extend the private sector, but we believe our goal should never be to do the job of the private sector – especially in light of the robust markets in many of our countries. In fact, we believe that our primary role is to support economic policies that allow the free market to flourish to ensure that the market can do its job in financing innovation. While this may sound obvious, it is something that policy-makers often lose sight of.

That is why our President has been so committed to a tax and regulatory policy that reduces the financial and administrative burden on small business so that their funds and energies are focused on making their businesses a success.

Our programs attempt to fill the gaps in the market; not duplicate what the market is already doing successfully. We're interested in leveraging the private financial network, not supplanting it. And admittedly, because of the depth and richness of the U.S. markets, we have the luxury of having a relatively focused role.

As we look at a company's development, from its seed and start-up phase through its early stage and into its growth stage, we need to look at the sources of capital available and the effectiveness of the marketplace in order to understand how government programs compliment the private

sector. I will give you a perspective of how the federal government programs in the U.S. work to do so.

SMEs drive much of the U.S. economy.

- They also account for more than 99 percent of all businesses
- Employ about half of the private sector workforce,
- Create more than half of nonfarm GDP
- and are the major driver of job creation.

Our economy regenerates as new businesses start and grow. Many of the companies that top our lists of industry giants are quite young and are born out of a culture and a marketplace that rewards innovation; and many of those companies like Apple, Costco, FedEx, Intel, and Staples – all Fortune 500 companies – received assistance from SBA programs.

More specifically, we know that SMEs in the United States also play an important role as drivers of innovation. Innovative SMEs produce 13 times more patents per employee than large patenting firms, and their patents are twice as likely as large firm patents to be among the one percent most cited. But, their access to innovation dollars is more restricted than in other sectors.

Research and development spending in the United States was more than \$340 billion last year – roughly 2.6 percent of our GDP. Of that, 65 percent

(\$223 billion) is spent by private industry. In 2004, companies with more than 500 employees accounted for more than 80 percent of private industry spending. Government is the second largest spender, with 28 percent (\$97 billion). Academic institutions and nonprofits, accounted for just over 8 percent (\$22 billion).

True research and development involves projects that are high risk – but frequently high reward – and therefore need a distinct form of capital that is patient. Large institutions are often funding research in response to a specific need or in pursuit of a specific end and they often have the cash resources to support their needs. SMEs and startups, on the other hand, do not have deep pockets and must often work with investors who are generally looking for a portfolio of opportunities that will balance those risks with potentially high rewards.

At the earliest stage, the private sector provides seed capital through an active industry of angel investors – wealthy individuals who invest in new and young companies. Angel investors have been an important part of seed financing for many years and are becoming more organized, their financing is becoming more robust, and their numbers are growing. In 2006, angels invested in more than 23,000 start-up businesses – more than half of all firms in which they invested. The total value of angel investments in 2006 was more than \$25 billion, about 10 percent higher

than the previous year. Funding from angel investors went primarily to health care (21 percent), software (18 percent), and biotech (18 percent).

The continuing growth and sophistication of the Angel market is especially important because the venture capital industry is changing. Venture capital has been a tremendous boon for American innovation over the years, but it is increasingly focused on making larger investments, and is shifting its attention downstream, so to speak. The average size of a venture capital investment is around \$4.3 million. New start-ups are often too small to be funded by venture capital, or too small for venture capital firms to consider it worthwhile to do the due diligence on.

While large corporations invest in R&D, primarily through in-house research, they recognize the ingenuity and resourcefulness of small innovators and often develop important partnerships with them, either as direct investors, through venture fund participation, or as part of their supply chain program. In these programs, SMEs become a vital part of partially outsourced product development strategy for large companies, which is both innovative and efficient. These programs, in turn, become critical sources of financing and revenue dollars that support innovation and success among SMEs.

One way the U.S. government, through the SBA, enables small business development is by insuring that small businesses receive a fair share of the government's spending on research dollars.

The U.S. government works to help innovative start-ups to get the money they need to finance research and development, and to take the first steps toward commercialization, through our Small Business Innovation Research Program, or SBIR program. Founded in 1982, SBIR is a program for federal agencies with external research budgets over \$100 million. Eleven federal agencies qualify, and they must reserve 2.5 percent of their extramural R&D dollars for the program.

The SBIR program provides around \$2 billion to small firms every year for innovation. This money reaches about 3,000 companies every year. As you might expect, this money usually supports firms in industries that specifically advance the respective agency's objectives: defense, IT, and health, for instance.

SBIR provides a grant, not a loan. There's no expectation of repayment, which keeps the program accessible to firms that are earlier stage. In addition, these funds may not go to companies that are majority owned by venture capitalists. There are many people who believe this money should be available to firms owned by venture capitalists, but we believe it is

important to have some level of funding for those ideas which are not receiving funding from financiers.

The federal government has a broader goal of supporting SMEs by incorporating them into its purchasing programs. They are often more flexible, and competitive than large companies – just harder to find. The U.S. government has a goal, not a quota, of spending a minimum of 23 percent of its procurement dollars with SMEs. All agencies have small business contracting goals, and large businesses that sell to the government have small business subcontracting goals. In 2006, SMEs received almost \$80 billion in prime federal contracting obligations, and more than \$60 billion in subcontracts.

Let me move on to discuss venture capital, which has been a critical enabler of innovation for decades. Venture capital in the U.S. is concentrated, both geographically and by industry. Communications and computer-related firms receive the lion's share of venture capital dollars, as do companies located in California and Massachusetts. Companies in the industrial and manufacturing sectors received a scant 2 percent of venture capital dollars.

The U.S. Government works to expand access to venture funding through Small Business Investment Companies, which are privately owned venture

capital funds that can match every dollar of privately raised capital with \$1 to \$2 in government funding.

Last year SBICs invested more than \$2 billion in small business. The entire portfolio is close to \$20 billion, of which more than \$9 billion is private capital.

Investments from SBICs are smaller than the venture industry average. While the average venture capital investment is more than \$4 million, the average SBIC investment is less than \$1 million. SBICs are more geographically diverse, and invest in a wider variety of industries. Investments in industrial and manufacturing companies were roughly one-quarter of all SBIC investment, compared to two percent of investment from the overall venture industry. And while more than half of all venture funding went to California and Massachusetts, only around 20 percent of SBIC funding went to those two states.

Of their \$2 billion investment in small business, SBICs invested close to \$600 million in start-up companies last year. SBICs are licensed in two programs: Participating securities (an equity program) and debenture securities. At this point, though, we've stopped issuing licenses for the participating securities program, because of the significant cost of the program. These investments are inherently risky, and the program was structured with insufficient protections for the government, so defaults

among the participating securities program resulted in significant losses. That program is therefore being concluded, although Congress continues to look at alternatives for a better structure.

The debenture program requires the venture firm to make regular interest payments, which means they need to have a positive cash flow. Debenture financing is obviously better suited for small businesses that have moved beyond their start-up phase. That program is able to run at very little cost to the taxpayer.

Let me turn now to the broader lending markets. Our flagship guaranteed lending programs enable private lenders to make loans to entrepreneurs that the lenders would otherwise not make, and therefore expand the number of small businesses receiving financing.

In recent years, we've expanded our efforts to reach more businesses. And, it appears our work is paying off. Since 2002, our loan volume has doubled to more than 110,000 approved loans in fiscal 2007. Those approved loans have a value of more than \$20 billion. Around 30 percent of approved dollars (\$6 billion) were for start-ups (though not necessarily innovative ones). Our overall portfolio has a value of more than \$60 billion, or roughly 10 percent of the value of outstanding small business loans in the United States.

In our loan programs, interest rates are determined by the lending institutions but subject to a maximum rate we set. The lenders profit from these loans – otherwise there wouldn't be any incentive for them to work with us.

Another very important feature of our primary loan programs is the fees cover the cost of loan defaults. The administrative costs are paid by the taxpayer, but by charging fees on our loans, we don't rely on an appropriation to fund the program. This means we won't run out of money during the year as the program grows. It also means that bankers can market the product as aggressively as they want and don't have to worry about the program being shut down later in the year because of a lack of funding.

Our purview in our lending programs is beyond simply enabling innovation; we support small business success in many forms, especially in communities that need it most. These are communities that suffer higher than average unemployment and poverty. We do this for many of the same reasons that we strive to enable the success of innovative companies: they create jobs, create wealth and drive our economy.

So, our programs cover a number of needs and forms of financing,

- Grants to support government-driven research
- Funds to extend the reach of venture capitalists

- Government procurement dollars directed to small business, which expand their opportunity
- And guaranteed lending programs which enable the banking sector to extend its reach.

Behind all of these programs is a belief that ownership is a powerful force that we want to foster. When someone owns a small business, it creates a different level of commitment to its success and future.

I'll leave you with a quote from President Bush on this subject:

"...if you own something, you have a vital stake in the future of our country. The more ownership there is in America, the more vitality there is in America, and the more people have a vital stake in the future of this country."